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140852Z Mar 05

UNCLAS SECTION 01 OF 02 MADRID 000953

SIPDIS

DEPARTMENT PASS TO EUR/WE, EB/TRA

E.O. 12958: N/A

TAGS: ELTN ECON SP

SUBJECT: SPAIN: RAILROAD PRIVATIZATION AND HIGH SPEED DEVELOPMENT

¶11. SUMMARY The European Commission mandated the privatization of Europe's railroad transportation network by the year 2013, impelling Spain to take its first steps in this direction. The Spanish cargo market is currently open for competition, however government restrictions make it likely that only EU companies will compete in the near future. Passenger service is expected to be privatized by 2010, although privatization delays in other EU countries could cause the GOS to roll back its target date. The GOS plans to increasingly utilize high speed service for passengers and cargo, with plans to expand a nascent high speed railway network to integrate with the rest of Europe. This process may offer interesting opportunities to U.S. investors. END SUMMARY

//BACKGROUND//

¶12. The Spanish railroad company, La Red Nacional de Ferrocarriles (Renfe), was formed in 1941 by the Franco government. Prior to that, the Spanish railroad system was a conglomeration of private regional systems utilizing different trains, signs and rules. It has since evolved into one of Spain's primary means of transportation. A high point in Renfe's history came in 1992, when it commenced its first high speed train service between Madrid and Seville. EU Directive 2002/291, which modified the original 1991 railroad directive, mandates the privatization of Europe's railway network by the year 2013, causing Spain to take its first steps towards railway privatization in 64 years.

//NEW ORGANIZATION//

¶13. Effective January 1, 2005, the Spanish government dissolved Renfe and formed two new companies, both of which remain under state control. The first company, Administrator de Infraestructuras Ferroviarias (ADIF), was formed when Renfe was merged with Gestor de Infraestructuras Ferroviarias, the state-owned company responsible for building and maintaining the country's high-speed railroad network. ADIF will have responsibility for the construction and maintenance of Spain's entire railway network, both high and low velocity. The company retains approximately half of Renfe's 32,000 original employees, as well as its railway stations, and will collect profits by charging operators a fee for the use of the railway infrastructure.

¶14. The second company was spun off from Renfe and is called Renfe-Operadora. It is a combined cargo and passenger transportation company that will have to compete with other firms in those markets. Renfe-Operadora received approximately EUR 2.3 billion in assets from the old company, primarily consisting of rolling stock and repair sheds. It will employ the other half of Renfe's original employees, of whom 5,000 will work in the maintenance division. In this spin-off process, the Spanish government assumed 80 percent of Renfe's historical debt (EUR 5.5 million out of EUR 7.3 million).

//FIRST STEPS//

¶15. Econoff met with Angel Martinez-Conde Ibanez, Railway Transportation Coordinator for the Spanish Ministry of Development, to discuss Renfe's privatization. Martinez stated that Spain's railroad privatization will take place in stages, with the goal of full compliance with the EU directive by 2010. Of note, he stated that ADIF will remain under government control even after the privatization process in cargo and passenger transportation is concluded. He commented that other EU countries, specifically citing Italy, may privatize their infrastructure during this process but that the GOS had no such plan.

¶16. The first stage of privatization, which took effect on January 1, allows for private competition in the Spanish cargo transportation market. Martinez stressed that the cargo market was more important than the passenger market in Spain, as the majority of cargo is moved via railway. As of March 3, the Spanish government had not received any applications from potential competitors to operate in the cargo market. Martinez stated that there are seven or eight companies interested in applying and he expects to receive the first applications within the next 6-7 months.

¶17. Martinez stated that the GOS was hoping to achieve full

privatization of the passenger market by 2010, three years before the EU deadline. However, he stated that Spain can not set a firm date because of privatization delays in other EU countries. He stated that Spain would seek to proceed with liberalization in conjunction with other EU countries and that delays in neighboring countries, naming France specifically, could cause the GOS to roll back its target date.

//PRIVATE COMPETITION//

¶18. Martinez stated that, although the Spanish market will be open to competition by foreign companies, there will be several restrictions. First, Martinez stated that the GOS utilizes a reciprocity schedule, permitting companies from foreign countries to operate within Spain under the same rules that the foreign country implements domestically in regard to Spanish companies. He cited China as an example of a country that would not be allowed to compete in the Spanish market, due to its closed domestic market. In addition to reciprocity, there are restrictions in regard to the use of Spanish railways by foreign trains. He stated that foreign trains brought to Spain for use in the domestic market would not be allowed to use Spanish railroad tracks until they had been inspected and certified as being in compliance with Spain's technical interoperability standards (ETI).

¶19. Martinez stated that companies must obtain two separate documents to operate within Spain. The first document is an EU railroad license, which can be obtained from the GOS, good for use in any EU country. The second document is a security statement, which is a combination of professional insurance and a list of operating conditions to which the holder has agreed. Martinez stated that the security statement must have a Spain-specific clause, in addition to the general EU portion. Martinez commented that due to these restrictions, foreign investors would benefit from incorporating within Europe or entering into joint ventures with European companies rather than attempting to enter the market from without.

//HIGH SPEED FUTURE//

¶10. In February, the GOS received sixteen new high speed trains, produced by the consortium Talgo-Bombardier, signaling Spain's commitment to the development of this market. The trains will initially travel at 200 km/hr, with speeds gradually increasing to 300 km/hr over the summer of 2005. The Spanish press reports that the trains can travel at a maximum speed of 350 km/hr, but that the Spanish infrastructure can not handle that velocity at this time. Currently, Spain has only two high speed lines: one connecting Madrid and Seville; and a second, recently completed, connecting Madrid and Lleida. The Madrid/Lleida line is currently being extended to Barcelona, with construction due to be completed in 2007.

¶11. Martinez stated that high velocity trains are going to be given priority development, with the GOS planning to construct a nationwide network of high speed passenger lines. This system will be integrated with the rest of Europe, via France, utilizing a tunnel to be constructed along the eastern coast of Spain, north of Barcelona. The GOS also plans to connect all regional capitals with Madrid. Martinez stated that the GOS is also working on a high speed system for cargo, but that it has encountered difficulties resolving weight issues and the sharing of high speed lines by both passenger and cargo trains. He further stated that only the Madrid-Seville line is ready for the high speed transportation of cargo.

//COMMENT//

¶12. The privatization of Spain's railway system is unlikely to have a serious impact on operations in the near future. The slow rate of privatization, combined with somewhat restrictive entrance conditions, make it likely that Renfe-Operadora will remain the major player in the cargo and passenger markets, along the lines of former state-held telecommunications monopoly Telefonica. Ticket prices have been rising steadily, but the Socialist government is not likely to allow exorbitant increases. Spain's high speed network is clearly the future of Spanish railroad transportation and may offer interesting opportunities to U.S. investors.

MANZANARES